

Sewer Service and Use Charge Fund

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T*o account for the financing, construction, and operation of the sanitary sewer system and for San José's share of the financing, construction, and operation of the regional San José/Santa Clara Water Pollution Control Plant (WPCP). Services provided through this fund are:*

- *Sewer maintenance;*
- *Sewer rehabilitation; and*
- *Sewage treatment at the Water Pollution Control Plant*

Sewer Service and Use Charge Fund

Budget Summary

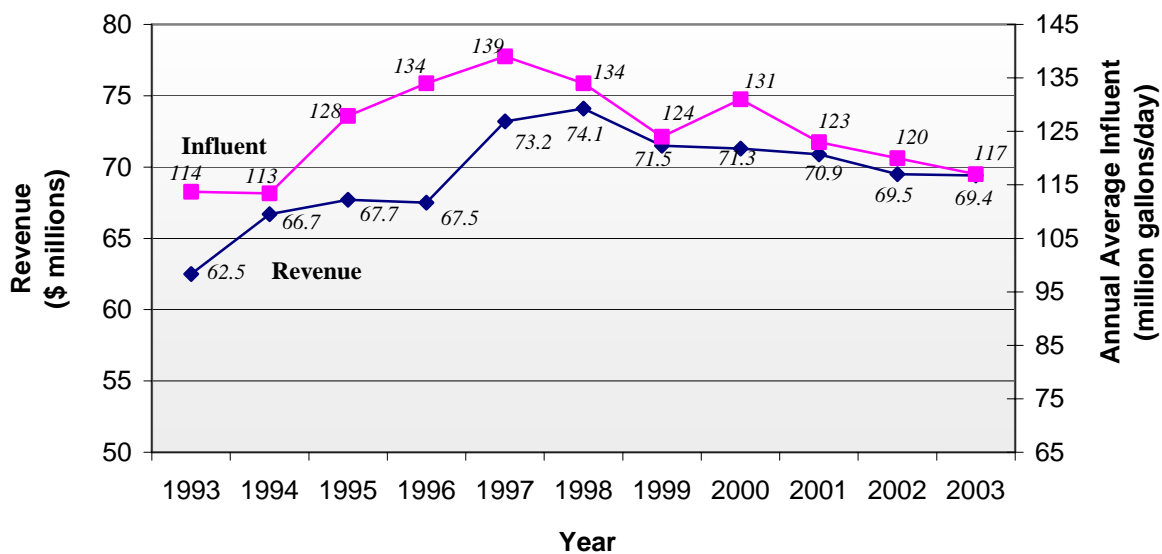
	2003-2004 Adopted	2004-2005 Adopted	Change
Sewer System Maintenance and Admin.	\$ 18,872,703	\$ 19,417,680	2.9%
Sanitary Sewer Rehabilitation	\$ 16,000,000	\$ 14,475,000	(9.5%)
Water Pollution Control Plant	\$ 50,752,120	\$ 44,754,736	(11.8%)

Budget Highlights 2004-2005

- Implementation of a three-year rate increase strategy to the Sewer Service and Use Charge fees of 4.5% annually was approved.
- Seven vacant support positions from within the Environmental and Utility Services CSA have been converted to line positions at the Water Pollution Control Plant to fulfill additional maintenance needs at the treatment plant.

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Sewer Service and Use Charge Fund Historical Trend of Revenues in relation to Influent Flows (millions of gallons per day compared to revenue in millions)



Sewer Service and Use Charge Fund

Fund Overview

This fund serves as the primary revenue source for several other funds which include the San José-Santa Clara Treatment Plant Operating and Capital Funds, and the Sewer Service and Use Charge Capital Improvement Fund, through annual transfers. In cooperation with the Departments of Environmental Services, Public Works, and Transportation, these funds are managed to deliver services in the most efficient and cost-effective manner.

The primary source of this fund's revenue is the fees paid through tax-based assessments within the residential, commercial, and industrial sectors. Since 1994-1995, these fees have remained at the same rate. During the majority of this period, the revenue growth in each of these sectors was sufficient to keep pace with the associated inflation factors for the maintenance and operations of the sanitary sewer system and treatment plant. Moreover, the rate structure and growth allowed a sufficient fund balance to help defer capital costs associated with the next cycle of system maintenance and rehabilitation.

During the past four years, however, the Sewer Service and Use Charge Fund has experienced flat or declining revenues, in relation to two primary factors. First, the downturn in the economy has slowed revenue growth as residential development has decreased, rendering the growth rate to below 0.5%. Second, and more significantly, industrial and commercial migration from the area has substantially reduced revenues from these sectors.

Specifically, 3.5% of the decreased revenues are the result of six large industrial users that ceased operations in San José during the past four years, representing a loss of \$2.6 million in annual revenues. The combined impact of the economic downturn and commercial and

industrial migration over the past several years has reduced revenues by a level equivalent to 6% from the high point in 1998-1999.

As a result, since 1999-2000, expenditures have exceeded revenues, resulting in deficit spending, and the fund balance has been drawn down as a consequence of the revenue shortfall. This significant and steady reduction of the available fund balance, if not mitigated, would drop the balance below the stated goal of 15% of annual operating expenses beginning next year.

Included in the fund balance is a Rate Stabilization Reserve of \$2 million, which was established in response to covenants in the bonds issued in 1995 to finance the construction of the South Bay Water Recycling project. The annual debt service cost for this project is \$7.3 million or about 10% of revenues.

As a result of these trends, without rate increases, the fund will be unable to adequately cover the future costs of operations and impending necessary capital maintenance and rehabilitation to the sanitary sewer system and treatment plant.

Although the majority of the operating expenditures associated with this fund have followed a stable and predictable rate of inflation, there have been several items that have exceeded expenditure projections during this period. Most notable among these has been the increase in energy costs over the past three years. Natural gas and electricity costs at the treatment plant have risen significantly despite numerous energy efficiency programs that have reduced the energy demand per million gallons treated. Other items that have exceeded the general rate of inflation include vehicle and facility maintenance costs, workers' compensation costs, and insurance.

Sewer Service and Use Charge Fund

Fund Overview (Cont'd.)

As operating expenses are increasing, the Plant's capital infrastructure needs are becoming ever more critical. Over 50% of the Plant's infrastructure exceeds 30 years of age, reflecting the expansion to an advanced wastewater treatment facility in the early to mid 1970's. Several major components of the treatment plant are reaching the end of their useful years of service, thereby creating the need for several critical infrastructure upgrades and rehabilitation projects which are described in the 2005-2009 Adopted Capital Improvement Program.

In addition to the impending rehabilitation projects necessary over the next ten years, it will be necessary to fund a number of planned security projects at the treatment plant. The most critical project with the greatest budgetary impact is the conversion from

gaseous chlorine as the primary disinfection source to safer methods. The completion of the project, estimated for 2005-2006, is projected to increase chemical costs by \$3.5 million, or approximately 5% of current year revenues.

In order to maintain the fund's viability and solvency, fund necessary system operations and maintenance requirements, and address critical infrastructure rehabilitation needs, rate increases of 4.5% in each of the next three years were approved. These increases will generate additional revenue of \$3.4 million in 2004-2005 and over the course of the three years, are projected to bring in an additional \$10.8 million.

Fund Summary

	2002-2003 Actual 1	2003-2004 Adopted 2	2004-2005 Adopted 3	% Change (2 to 3)
Dollars by Sources				
Beginning Fund Balance	\$ 27,064,825	\$ 23,198,459	\$ 16,995,440	(26.7%)
Sewer Service and Use Charges	71,148,957	69,165,899	71,551,157	3.4%
Interest and Other	715,817	545,300	487,196	(10.7%)
Transfers	8,923,557	8,098,120	52,000	(99.4%)
Total	\$ 107,853,156	\$ 101,007,778	\$ 89,085,793	(11.8%)
Dollars by Uses				
Sewer System Maintenance and Admin.	\$ 15,875,334	\$ 18,872,703	\$ 19,417,680	2.9%
Sanitary Sewer Rehabilitation	16,000,000	16,000,000	14,475,000	(9.5%)
Water Pollution Control Plant	50,543,557	50,752,120	44,754,736	(11.8%)
Ending Fund Balance	25,434,265	15,382,955	10,438,377	(32.1%)
Total	\$ 107,853,156	\$ 101,007,778	\$ 89,085,793	(11.8%)

Sewer Service and Use Charge Fund

Budget Category: Sewer System Maintenance and Administration

Budget Category Overview

This program is responsible for sewer system maintenance and administrative services. System Maintenance is performed by the Department of Transportation, the Department of Public Works, and the General Services Department to repair damaged sewer pipes and maintain

the system infrastructure. Information Technology Department service costs are also included in this category. Administrative Services include support services provided by various City departments, overhead to the General Fund, fees charged by the County for collecting assessments, and audit costs.

Budget Category Summary

Sewer System Maintenance and Administration	2002-2003 Actual 1	2003-2004 Adopted 2	2004-2005 Adopted 3	% Change (2 to 3)
Sewer System Maintenance	\$ 9,606,436	\$ 11,499,914	\$ 11,608,144	0.9%
Administrative Services	6,268,898	7,372,789	7,809,536	5.9%
Total	\$ 15,875,334	\$ 18,872,703	\$ 19,417,680	2.9%

The following changes were approved in 2004-2005 in the Sewer System Maintenance and Administrative Services allocation:

Adopted Allocation	2003-2004 Adopted	Change	2004-2005 Adopted
Sewer System Maintenance	\$ 11,499,914	\$ 108,230	\$ 11,608,144

Increases to the Sewer System Maintenance Program for the 2004-2005 Adopted Operating Budget reflect benefits cost increases in the Departments of Transportation, Public Works, General Services and Information Technology (\$115,412), and approved staffing and vehicle maintenance changes in the Department of Transportation (\$18,330). These increases are partially offset by staffing changes in the Environmental Services Department (\$24,396) and the Finance Department (\$1,116).

Administrative Services	7,372,789	436,747	7,809,536
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Changes in the Administrative Services Program for the 2004-2005 Adopted Operating Budget are primarily due to rising sanitary sewer claims (\$225,000); benefits cost increases in the Environmental Services Department, Finance Department, City Attorney's Office, and the Office of the City Manager (\$233,167); and Civic Center Start-up costs (\$7,758). These increases are partially offset by approved staffing realignments and efficiency savings in the Environmental Services Department (\$24,396) and overhead (\$4,782) savings.

Total Sewer System Maintenance and Administration	\$ 18,872,703	\$ 544,977	\$ 19,417,680
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Sewer Service and Use Charge Fund

Budget Category: Sanitary Sewer Rehabilitation

Budget Category Overview

The Sanitary Sewer System Rehabilitation Program consists of capital projects designed to rehabilitate the sanitary sewer system, with higher priorities given to those with extensive, severe

deterioration. Rehabilitation projects of existing sewers are selected on the basis of pipe corrosion studies, maintenance reports, infiltration analysis, and actual pipe failures.

Budget Category Summary

	2002-2003 Actual 1	2003-2004 Adopted 2	2004-2005 Adopted 3	% Change (2 to 3)
Sanitary Sewer Rehabilitation				
Transfer to Capital Fund	\$ 16,000,000	\$ 16,000,000	\$ 14,475,000	(9.5%)
Total	\$ 16,000,000	\$ 16,000,000	\$ 14,475,000	(9.5%)

The following changes were approved in 2004-2005 in the Transfer to Capital Fund allocation:

Adopted Allocation	2003-2004 Adopted	Change	2004-2005 Adopted
Transfer to Capital Fund	\$ 16,000,000	\$ (1,525,000)	\$ 14,475,000

The Sanitary Sewer System Rehabilitation program has been for a number of years funded by an annual transfer of \$16 million to the Sewer Service and Use Charge Capital Improvement Fund from the Sewer Service and Use Charge Fund to support the costs of rehabilitation of existing sewers. For 2004-2005, however, a decrease of \$1.525 million in that transfer amount was approved. This is a necessary response to the ongoing deficit spending within the Sewer Service and Use Charge Fund described above. As within the other categories of this fund, reductions and deferment of capital projects will be necessary until the fund can be returned to a self-supporting basis. Major projects currently in the planning or construction stages include those related to the rehabilitation of the Major Interceptor System, neighborhood sewers, and the Inflow and Infiltration (I&I) Reduction projects. The rehabilitation projects will prevent and/or correct pipe failures such as collapses, flow stoppage, and the spilling of sewage. The specific elements of this program are described in the 2005-2009 Adopted Capital Improvement Program.

Total Sanitary Sewer Rehabilitation	\$ 16,000,000	\$ (1,525,000)	\$ 14,475,000
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Sewer Service and Use Charge Fund

Budget Category: Water Pollution Control Plant

Budget Category Overview

This program provides for operational costs, support services, and debt service requirements for the San José/Santa Clara Water Pollution Control Plant (WPCP). This regional wastewater treatment facility serves eight tributary sewage collection agencies, including municipalities and sanitary

sewer districts. The WPCP processes wastewater, operates a Biosolids Reuse Program, and administers the South Bay Water Recycling Project. In addition, it plans, designs, and constructs new wastewater treatment facilities and provides system maintenance.

Budget Category Summary

	2002-2003 Actual 1	2003-2004 Adopted 2	2004-2005 Adopted 3	% Change (2 to 3)
Water Pollution Control Plant				
Treatment Plant Operating Fund	\$ 40,565,000	\$ 38,000,000	\$ 32,000,000	(15.8%)
Treatment Plant Capital Fund	1,055,000	5,454,000	5,456,000	0.0%
SBWR Revenue Bonds ('95)	5,956,430	7,298,120	7,298,736	0.0%
SJ/SC CWFA Payment ('97)	2,967,127	0	0	N/A
Total	\$ 50,543,557	\$ 50,752,120	\$ 44,754,736	(11.8%)

Transfers to the above wastewater-related funds support the operating, capital, and debt service costs of the Water Pollution Control Plant.

One of the primary sources of expenditures in the past several years has been diversion activities associated with the 120 million gallons per day (mgd) flow trigger to the South San Francisco Bay. The diversion of fresh water effluent from the Bay prevents saltwater marsh conversion. This diversion of fresh water has been primarily achieved through the Revised South Bay Action Plan (Plan), as approved by City Council in June 1997.

The projects within this Plan include expanded water recycling, industrial water recycling/reuse, inflow/infiltration reduction, and environmental enhancement pilots. Recycled water is used by industrial and institutional users, diverting water that would otherwise be

discharged to the Bay. For 2004-2005, approximately 11.5 mgd of recycled water is projected to be delivered to customers during the dry weather period, which represents a one mgd increase compared to the 2003-2004 estimated amount. This increase is in large part due to the addition of the Metcalf Energy Center (MEC) as a customer. MEC is scheduled to begin operations by the end of 2004-2005; and future years should see a demand of recycled water averaging about five mgd annually.

For the reporting period during 2003, the dry weather flow averaged 100 mgd. This effluent flow measure reflects the continuing trend of reduced flows to the Bay. The 2002 reported effluent was 102 mgd representing a significant reduction from 2000 level of 116 mgd. These decreased effluent flows reflect the decline in economic activity as well as increased recycled water usage.

Sewer Service and Use Charge Fund

Budget Category: Water Pollution Control Plant

Budget Category Summary (Cont'd.)

The following changes were approved in 2004-2005 in the support of this fund to the Treatment Plant Operating Fund, Treatment Plant Capital Fund, and SBWR Revenue Bonds ('95) allocations:

Adopted Allocation	2003-2004 Adopted	Change	2004-2005 Adopted
Treatment Plant Operating Fund	\$ 38,000,000	(6,000,000)	\$ 32,000,000
For 2004-2005, a decrease of \$6.0 million to the transfer from the Sewer Service and Use Charge Fund to the Treatment Plant Operating Fund was approved due to a better than expected ending fund balance from savings generated over the past year. This additional balance has resulted from both efficiency savings and a decrease in certain support and outreach programs that were of a lesser priority due to the continued decrease in influent. A reduction of \$911,000 in the Environmental Services Department Water Efficiency Programs (e.g. Ultra-Low Flow toilet replacement) was also approved. This reduction is possible because flows from the Water Pollution Control Plant are well below the 120 mgd permit requirement due to a combination of the downturn in the economy and the success of water conservation programs and increased use of recycled water.			
Treatment Plant Capital Fund	5,454,000	2,000	5,456,000
The small increase in the transfer amount reflects the adjusted contribution for the San José portion of the ongoing capital improvement projects at the San José/Santa Clara Water Pollution Control Plant, such as the major reliability project currently entering the final design phase.			
SBWR Revenue Bonds ('95)	7,298,120	616	7,298,736
The slight increase reflects the previously established debt-service schedule for this series of bonds.			
Total Water Pollution Control Plant	\$ 50,752,120	\$ (5,997,384)	\$ 44,754,736